No. 79-1013

In the Supreme Court of the United States

OCTOBER TERM, 1979

WILLIAM RUBIN, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-67a) is reported at 609 F.2d 51.

JURISDICTION

The judgment of the court of appeals was entered on September 6, 1979, and a petition for rehearing was denied on November 20, 1979. The petition for a writ of certiorari was filed on December 19, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether petitioner's pledge of stock as collateral for a loan was a "sale" of a security (a term defined by statute to include any disposition of an interest in a security for value) and was thus subject to the antifraud provision of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a).

2. Whether the government was required under *Brady* v. *Maryland*, 373 U.S. 83 (1963), to disclose the criminal record of a co-conspirator who did not testify at petitioner's trial.

3. Whether the district court properly admitted into evidence certain interview notes after petitioner's counsel made extensive use of those notes to cross-examine a government witness.

STATUTES INVOLVED

Section 2(3) of the Securities Act of 1933, 15 U.S.C. 77b(3), provides in pertinent part:

> The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term * * * "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communica-

tion in interstate commerce or by the use of the mails, directly or indirectly—

> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

STATEMENT

Following a jury trial in the United States District Court for the Southern District of New York, petitioner was convicted on one count of conspiracy to engage in securities fraud (15 U.S.C. 77q(a)), fraud in a bank loan application (18 U.S.C. 1014), mail fraud (18 U.S.C. 1341), and wire fraud (18 U.S.C. 1343), in violation of 18 U.S.C. 371. He was sentenced to three years' imprisonment. The court of appeals affirmed.

The evidence adduced at trial established that petitioner participated in an elaborate scheme to obtain bank loans for a financially failing company, Tri-State Energy, Inc. ("Tri-State"), by use of material misrepresentations, false documents, and bribery, and by pledging worthless securities as collateral.

Beginning in October 1972, petitioner and two other officers of Tri-State sought to obtain loans for Tri-State from Bankers Trust Company (Tr. 665, 1368).[1] Petitioner was acquainted with Raymond Ludwig, the officer at Bankers Trust who was in charge of corporate loans, and arranged a meeting with him (Tr. 665, 1368). Initially, Ludwig stated that a loan could not be made because Tri-State could not adequately document its assets or earnings potential (Tr. 666-667, 1368-1369). As he left the bank, petitioner told Ludwig: "[I]f you can see your way clear to help us, we will take care of you" (Tr. 667).[2]

To assure Ludwig and the other bank officers about Tri-State's financial condition, petitioner helped to prepare a financial statement that was materially false and misleading (Tr. 667-669). The financial statement listed a $7.5 million account receivable as Tri-State's principal asset, and a copy of the contract that purported to reflect this receivable was attached to the statement (Tr. 344, 349). In fact, no such receivable existed and the signature on the contract was forged (Tr. 641-647). At petitioner's suggestion, this "asset" was balanced on the financial statement by a

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[1] Two officers of Tri-State (Leonard James and C. W. Deaton) and two other co-conspirators were indicted along with petitioner. James was convicted at a separate trial. Deaton has not yet been tried.

[2] One witness recalled that a different Tri-State officer made this statement to Ludwig and that it was later reported to petitioner (Tr. 1369). In either event, petitioner knew that Ludwig had been offered a bribe in connection with the loan application.

fictitious tax liability (Tr. 668). In addition, the financial statement, as originally prepared, listed $200,000 in cash on hand, attributable to two undeposited and uncashed personal checks, and $64,000 in cash in bank accounts (Tr. 668-669). Petitioner observed that these cash items would look suspicious, and, at his urging, the items were consolidated and listed as cash on hand with no explanation (*ibid.*). Finally, the financial statement indicated that Tri-State owned coal worth $180,000, when, in fact, it owned far less than that amount (Tr. 157-158, 667-668, 1391-1392). After this false information was furnished to the bank, the bank approved an initial loan of $50,000 (Tr. 674-675).

Shortly thereafter, petitioner and the two other Tri-State officers agreed that Ludwig should be paid the promised bribe as soon as possible (Tr. 675, 1369-1370). Accordingly, petitioner cashed a check for $1,500 at his country club and gave the money to Ludwig (Tr. 676, 1371). Later, petitioner gave Ludwig an additional $2,500 and made two $500 payments to a second bank official who approved the Tri-State loan (Tr. 211, 218, 315-316, 678-679, 1372-1373).

During the next six weeks, Tri-State was able to borrow an additional $425,000 from the bank (Tr. 1130). Petitioner engaged in a number of fraudulent acts to convince the bank that the loan was secure and to persuade it not to call the loan. For example, petitioner gave a bank officer a written projection of Tri-State's revenues that indicated that Tri-State

would receive $540,000 in gross income (Tr. 365-366). In fact, this projected income was based in substantial part on non-existent business contracts (Tr. 1109-1115, 722-723).

Another method used to conceal Tri-State's precarious financial position was the pledge of nearly worthless stock as collateral for the loans. At the request of a bank officer, petitioner agreed that Tri-State would provide marketable securities as collateral (Tr. 246). Between October 1972 and January 1973, Tri-State pledged the stock of several companies as collateral and represented that these securities were owned by Tri-State and were freely marketable (Tr. 305-313). In fact, Tri-State did not own the stock but only "rented" the shares (Tr. 682-684, 1394-1395). The shares were not freely tradeable and had no current market (Tr. 1490-1491). Petitioner created the appearance that one stock was marketable by engaging in apparent purchase and sale transactions so that the name of the stock would appear in the daily listings of an over-the-counter brokerage firm (Tr. 686-688, 1269-1273). Tri-State also tried to create the appearance of marketability in another stock pledged as collateral by showing a bank officer a newspaper clipping indicating that the stock was trading for about $20 a share (Tr. 410-411). In fact, the clipping was not a stock quotation at all but rather was an advertisement placed at the request of Tri-State (Tr. 723). Later, when the lessor of this stock discovered that it had been pledged, he informed the bank officer that Tri-State did not own it and

that it was restricted (Tr. 420-421). The bank officer then called petitioner, who claimed that Tri-State had been defrauded by the lessor and that he would have his attorney look into the matter (Tr. 421-423).

Tri-State was unable to repay the loans as they matured and Bankers Trust was forced to consolidate the loans into a single demand note (Tr. 284, 286-288). The bank was able to recover only $2,500 of the $475,000 (plus interest and expenses) that Tri-State was obligated to repay (Tr. 1129).

DISCUSSION

1. The principal question raised in the petition for certiorari (Pet. 7-14) is whether Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), which prohibits fraud "in the offer or sale of any securities," extends to fraud in the pledge of securities. The district court correctly determined that fraud in the pledge of securities is prohibited by Section 17(a) (Tr. 1554-1555) and the court of appeals affirmed that disposition.[3] Nevertheless, in view of the conflict among the courts of appeals on this issue and the importance of the issue to the enforcement of the federal securities laws, the United

[3] This question was fully briefed by the parties in the court of appeals. Petitioner's contentions were summarily rejected by the court without discussion (Pet. App. 34a). The court of appeals appears to have relied on its earlier holding in *United States* v. *Gentile*, 530 F.2d 461, 466-467 (2d Cir.), cert. denied, 426 U.S. 936 (1976), that a pledge is a "sale" within the meaning of the Securities Act.

States does not oppose granting the petition on this question.[4]

The split among the courts of appeals is illustrated by a comparison of the decisions of the Second Circuit with those of the Fifth and Seventh Circuits. The Second Circuit, in the present case and in *United States* v. *Gentile*, 530 F.2d 461, 466-467 (2d Cir.), cert. denied, 426 U.S. 936 (1976), has held that a pledge of securities is a "sale" within the meaning of Section 17(a). The Fifth and Seventh Circuits have reached the opposite conclusion. *National Bank of Commerce* v. *All American Assurance Co.*, 583

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[4] Three years ago, this Court granted certiorari to resolve the related question whether a pledge of stock is a sale of a security under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b). *Bankers Trust Co.* v. *Mallis*, 431 U.S. 928 (1977). That statute defines "sale" to include "any contract to sell or otherwise dispose of" a security. Section 3(a)(14) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(14). The Court dismissed the petition as improvidently granted after the respondents during oral argument changed the theory upon which they sought affirmance. 435 U.S. 381 (1978).

There is also a conflict among the circuits on the question whether a pledge is a sale under Section 10(b). Compare *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1028-1030 (6th Cir. 1979), and *Mallis* v. *FDIC*, 568 F.2d 824, 828-830 (2d Cir. 1977), cert. dismissed, 435 U.S. 381 (1978) (pledge is a sale under Section 10(b)), with *Lincoln National Bank* v. *Herber*, 604 F.2d 1038, 1040-1044 (7th Cir. 1979), *National Bank of Commerce* v. *All American Assurance Co.*, 583 F.2d 1295, 1298-1300 (5th Cir. 1978), *Reid* v. *Hughes*, 578 F.2d 634, 638 (5th Cir. 1978), and *McClure* v. *First National Bank*, 497 F.2d 490, 495-496 (5th Cir. 1974), cert. denied, 420 U.S. 930 (1975) (pledge is not a sale under Section 10(b)).

F.2d 1295, 1298-1300 (5th Cir. 1978); *Lincoln National Bank* v. *Herber*, 604 F.2d 1038, 1040-1044 (7th Cir. 1979).

We believe that the Second Circuit's position is correct. As with other questions of statutory interpretation, the starting point for analysis is the language of the statute itself. *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, No. 77-1645 (Nov. 13, 1979), slip op. 4. A pledge, the Second Circuit noted in *Gentile*, falls within the literal definition of a "sale" contained in Section 2(3) of the Securities Act of 1933, 15 U.S.C. 77b(3), which includes "every contract of sale *or disposition of a security or interest in a security*, for value" (emphasis supplied). 530 F.2d at 466. Restricting the term "sale" to transactions in which title to a security passes "would render superfluous" the statutory language emphasized above. *Ibid.*

The banking context in which pledge transactions frequently occur does not require a different result. The antifraud provisions of the federal securities laws are not limited to protection of investors. See *United States* v. *Naftalin*, 441 U.S. 768, 772-777 (1979). They protect creditors as well. See *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 & n.8 (1971).

The antifraud provisions of the federal securities laws were intended to apply when any person is deceived into parting with money in exchange for an interest in a security. As the Second Circuit has explained, "there is no reason to doubt that Congress

intended [the Securities] Act to protect defrauded lenders just as much as defrauded buyers," because pledgee-lenders, like investors, assume "a very real investment risk that the pledged securities will have continuing value." *United States* v. *Gentile*, *supra*, 530 F.2d at 467.[5] Petitioner's contrary interpretation "would create a loophole in the statute that Congress simply did not intend to create" (*United States* v. *Naftalin*, *supra*, 441 U.S. at 777) and would frustrate the purposes of the statute by permitting those who wilfully engage in fraud in securities transactions to go unpunished.

2. Petitioner's remaining contentions are insubstantial and do not warrant review by this Court. Petitioner argues (Pet. 14-17) that the prosecutor concealed material exculpatory information by failing to disclose the criminal record of Raymond Starns, who had written the two uncashed and undeposited personal checks falsely listed as "cash on hand" in the financial statement given to the bank.

An IRS agent testified (Tr. 669) that petitioner admitted knowing that the checks were worthless. The agent also recalled that petitioner had stated that he realized that Starns had served time in jail for passing bad checks. Starns did not testify at petitioner's trial, but he did testify at the separate trial of petitioner's co-indictees. At that time, Starns

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[5] This is particularly true where, as here, the financial condition of the borrower is weak at the time the loan is made. The lender must depend to a substantial degree on the value of the pledged securities to insure repayment of the loan.

stated that, although he had been arrested for passing bad checks in 1963, he was not convicted on that charge (James App. 320).[6] Starns also testified that, in 1973, he was again arrested for passing a bad check (*id.* at 322) and was later convicted for uttering forged securities (James Tr. 1241-1243).[7]

Petitioner's claim that the prosecutor's failure to disclose Starns' criminal record violated the rule of *Brady* v. *Maryland*, 373 U.S. 83 (1963), was never raised in the district court. It was not, therefore, properly presented in the court of appeals, which did not discuss it. There is accordingly no necessity for this Court to consider the question. *United States* v. *Lovasco*, 431 U.S. 783, 788 n.7 (1977).

In any event, the claim is frivolous. Starns was not a witness for the government at petitioner's trial. His criminal record therefore could have no impeachment value. Nor could disclosure of the information have created a reasonable doubt regarding petitioner's guilt that would not otherwise exist. See *United States* v. *Agurs*, 427 U.S. 97, 102 (1976). To the contrary, the evidence of Starns' record would have confirmed that petitioner's treatment of Starns' uncashed checks as "cash on hand" was even more misleading than it appeared to be.

Finally, even if petitioner could have used the information about the chronology of Starns' arrests

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[6] "James App." refers to the joint appendix filed in the court of appeals in *United States* v. *Leonard James, et al.*, No. 78-1346 (2d Cir.).

[7] "James Tr." refers to the transcript of the trial of petitioner's co-indictees.

and conviction to show that he did not know the full extent of Starns' criminal record at the time when he prepared the false financial statement, that would not have tended to exculpate him.[8] Petitioner still knew that the checks listed as "cash on hand" were uncashed and undeposited personal checks (Tr. 668-669). They were not properly reported as "cash" items (Tr. 351-353). Moreover, petitioner was responsible for a host of other misrepresentations to the bank, as noted above. In this factual context, the details of Starns' criminal record could not have created a reasonable doubt as to petitioner's guilt. *United States* v. *Agurs*, *supra*, 427 U.S. at 113-114.

3. Petitioner also claims (Pet. 17-19) that the district court improperly admitted into evidence several pages of notes as prior consistent statements of an agent who testified on behalf of the government. This claim is refuted in the thorough opinion of the court of appeals, on which we rely.[9]

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[8] There is no substance to petitioner's suggestion that the prosecutor knowingly used perjured testimony. The government agent testified only that petitioner stated to him that petitioner was aware, when the financial statement was prepared, that Starns had been in jail for passing a bad check (Tr. 668-669, 782-787, 887-890). The agent did not purport to testify about Starns' record; he merely repeated his recollection of petitioner's words during their interview. When petitioner testified on his own behalf, he did not contradict the agent's testimony on this point. Petitioner's counsel had the opportunity to, and did, extensively cross-examine the agent about his recollection of petitioner's statement regarding Starns (Tr. 782-787).

[9] Petitioner appears to challenge the analysis in Judge Friendly's concurring opinion rather than that of the court's

Petitioner was interviewed on several occasions by government agents before the indictment was returned in this case. Several agents took notes during these interviews. Agent Thomas Cox, who testified at petitioner's trial, did not personally take notes, but he was present at the interviews, examined the notes, and testified that the notes accurately reflected what had been said (Tr. 875). Agent Cox used the notes to refresh his memory during his direct examination (Tr. 652-653). Petitioner's counsel used the notes extensively during his cross-examination of Agent Cox, and even read from them repeatedly before they were admitted into evidence (Tr. 762, 767-768, 784, 798, 800, 801, 807, 811, 816, 819, 820, 852, 864, 867, 872). The purpose of this cross-examination was to create the impression that Agent Cox's testimony differed from the notes. On redirect the government offered four excerpts from the notes to show that the agent's testimony was consistent with them (Tr. 882, 887, 890, 897).

Petitioner now claims that this evidence should not have been admitted because it did not satisfy the requirements of Fed. R. Evid. 801(d)(1)(B), as discussed in *United States* v. *Quinto*, 582 F.2d 224, 233-234 (2d Cir. 1978). These requirements are that the prior statement must be consistent with the witness' in-court testimony, must be offered to rebut an ex-

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opinion (Pet. 17-19). However, Judge Friendly fully agreed with the court's analysis of the prior consistent statement issue (Pet. App. 35a) and joined in the judgment affirming petitioner's conviction.

press or implied charge of recent fabrication, and must be made before a motive to fabricate arose.

As the court of appeals pointed out (Pet. App. 23a), no objection was made to the receipt of one of the exhibits and petitioner's counsel had already read the supposedly objectionable portion of another exhibit to the jury before the government offered it (Tr. 852, 882). Moreover, as the court of appeals also observed (Pet. App. 26a), inasmuch as petitioner had used portions of the notes to impeach Agent Cox and had read extensively from them, the government was entitled to place these passages in context by introducing additional portions of the notes under the doctrine of completeness. Fed. R. Evid. 106. When substantial portions of a prior statement are used in cross-examination of a witness, fairness dictates that additional relevant portions be admitted to avoid misleading the jury. *United States* v. *Lev*, 276 F.2d 605, 608 (2d Cir.), cert. denied, 363 U.S. 812 (1960).

Finally, even assuming that admission of the four excerpts was improper, any error was clearly harmless. As the court of appeals explained (Pet. App. 27a-29a), the notes were either entirely consistent with Agent Cox's detailed oral testimony or related to merely peripheral matters. There is no reason to assume that these "few pages of cryptic phrases" (Pet. App. 29a) had any appreciable effect on the jury, in view of the detailed testimony of the government agents regarding what petitioner said to them.

CONCLUSION

We do not oppose granting the petition for a writ of certiorari limited to the question whether a pledge of stock as collateral for a loan is an "offer or sale" within the meaning of the Securities Act of 1933 (Question One). In all other respects, the petition should be denied.

Respectfully submitted.

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